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Supreme Court of the United States.

OCTOBER TERM, 1937.

No. 455.

FREDERICK S. DEITRICK, RECEIVER OF THE BOSTON-CONTINENTAL NATIONAL BANK, ET AL.,
Petitioners,
v.
STANDARD SURETY & CASUALTY COMPANY OF NEW YORK,
Respondent,

(AND SIX OTHER ACTIONS CONSOLIDATED THEREWITH).

BRIEF FOR STANDARD SURETY & CASUALTY COMPANY OF NEW YORK, RESPONDENT.

CORRECTIVE AND SUPPLEMENTAL STATEMENT OF THE CASE.

Facts.

Contrary to the statement on page 2 of the petition, the four so-called "note guaranty bonds" were *not* "executed by the Surety Company," but were signed in its name without authority, contrary to its instructions (R. 46), and without its knowledge, by its agent Cliff, at the request of Ragan, the president of the Bank, who knew (R. 47) of Cliff's lack of authority, who knew the Surety Company was ignorant of the bonds, and who assured Cliff that they would be used only to satisfy the bank examiner

and would then be returned to Cliff. The Bank, in obtaining the bonds, acted solely through Ragan (R. 53), who, as part of the same transaction in each case, gave Cliff releases running from the Bank to the Surety Company (R. 47, 50, 52). There was no negligence on the part of the Surety Company (R. 54).

Pleadings.

In the three actions at law each declaration was on the bond in question (R. 4, 152, 166). The defendant's answers in the actions at law consisted of general denials and the further answer, in each case, that the bonds were executed by Cliff without authority from the defendant, without consideration, and upon the understanding between Cliff and the Bank that they were not binding obligations of the defendant and would, after a short time, be returned to Cliff, and that the Bank had given releases (R. 21, 22, 155, 156, 168, 169). In none of the pleadings in the actions at law were there any allegations of reliance on the bonds by the bank examiners or by creditors or depositors of the Bank, or of injury to any creditor or depositor.

In the four suits in equity, brought by the Surety Company for cancellation of the bonds, each bill of complaint alleges in substance the same matter as that set up in the defendant's answers in the actions at law, as above described (R. 179, 211, 235, 258). By amendment in each case there are further allegations of an election of remedies by the receiver (R. 198, 232, 254, 276). The answers in the equity suits are the joint answers of the Bank and of the receiver, and contain no affirmative allegations besides denial of Ragan's authority to give Cliff releases by the Bank, and allegations in each case that the Surety Company is liable on the bond according to its terms (R. 194, 229, 252, 274).

There is no allegation in any of the pleadings in the suits in equity of reliance on the bonds by the bank examiners or by creditors or depositors of the Bank, or of injury to any creditor or depositor (R. 194, 229, 252, 274).

The Surety Company objected to the evidence offered by the receiver of reliance on the bonds by the bank examiner, and of reliance by and injury to creditors and depositors of the Bank (R. 90). The master and auditor in his report says:

> "It may safely be said that no possible objection on grounds of materiality have been waived" (R. 90).

The Circuit Court of Appeals, in denying the petition for rehearing, finds (R. 292, 293) that—

> "The plaintiffs (Bank and receiver) in their brief filed in this court say: 'Amendment of the pleadings have made the issues raised in the three law actions identical with the issues raised in the equity cases based on the same bonds.' * * *
>
> "No issue is raised in the plaintiff's brief except as to the validity of the bonds. The obligations of the Surety Company based on the depositors of the Bank being injured by the giving of the bonds, and the receiver's claim against the Surety Company based on a trust relationship are not mentioned. * * *"

Summary of Argument.

The questions sought to be raised by the petition, and by the petitioners' brief, cannot properly be raised on this record. Both petition and petitioners' brief ignore the procedural point upon which the decision of the Circuit Court of Appeals is based, namely, that the pleadings do not permit the claim here relied upon by the petitioners.

As the petitioners are limited by the pleadings, the case is, at best for the petitioners, well within the limits of the undisputed law established by decisions of this honorable Court.

Even if the petitioners were not so limited, there is no conflict of decisions on the facts found in this case such as to justify the petition. In none of the cases cited by the petitioners did a court allow recovery by a receiver against an innocent person, where the bank itself could not recover.

Argument.

I.

THE QUESTION OF LAW WHICH THE PETITIONERS URGE TO BE OF SUCH PUBLIC IMPORTANCE AS TO WARRANT A REVIEW BY THIS HONORABLE COURT IS NOT RAISED BY THE DECISION OF THE CIRCUIT COURT OF APPEALS.

The Circuit Court of Appeals based its decision upon the failure of the receiver to allege the facts upon which his present contention is based. In its opinion (R. 281), the court below says:

> (R. 285:) "Here is the principal issue in the case. The master and auditor held that the receiver in bringing these actions did not derive his right of recovery through the Bank, but because one or more creditors of the Bank were deceived, and as he represents creditors he derived his right of action through them. The receiver, however, makes no such allegations in his declaration * * *.
>
> * * * * * * * *
>
> (R. 286:) "It is clear from the pleadings that the receiver seeks to recover on these bonds as assets of

the Bank. In such an action he stands no better than the Bank itself. * * *

(R. 287:) "If, therefore, the contract with the Surety Company was illegal as to the Bank, because, as the master and auditor found that the Bank was charged with the knowledge of its president, a recovery based on the contract of surety cannot be had by the receiver, since recovery must be based on the pleadings, and the allegations of liability in the plaintiff's declarations are based solely on the contract of surety * * *. *There is no allegation in the declarations at law that the receiver based his grounds of action on any alleged deception of, or injury to, any creditors of the Bank, or that any creditors were directly or indirectly injured by the giving of the surety bonds, nor does the receiver allege that he is suing on account of any creditors so injured.* [Italics supplied.]

"The grounds of the action at law are that the bonds alleged to have been issued by Cliff to secure the notes of the several parties referred to in the declarations were between the Surety Company [R. 288] and the Bank, and were valid, binding obligations.

* * * * * * * *

"We think the auditor and master in his report went outside the issue raised by the pleadings. * * * "

* * * * * * * *

(R. 288:) "The questions of whether the receiver, having brought an action against the Fidelity & Deposit Company to recover on a bond issued to indemnify the Bank against the unlawful acts of Ragan in taking these bonds, the Surety Company can defend on the ground of an election of remedies, see *Minneapolis National Bank* v. *Liberty National Bank,* 72 Fed. (2d) 434, 436, or for lack of notice of default in the

payment of the notes, we do not decide, since *there can be no recovery by the receiver on the pleadings in the case.*" (Italics supplied.)

The petitioners here petitioned the Circuit Court of Appeals for a rehearing on the ground that the prayers of the petitioners in their counterclaim to the bills in equity were general (R. 289, 290). The court below denied the petition for rehearing, saying in its opinion (R. 291, 292, 293):

> "The plaintiffs cite their prayer in their petition for rehearing, but a prayer must follow the allegations in the complaint or counterclaim.
>
> • • • • • • • •
>
> "The plaintiffs in their brief filed in this Court say: 'Amendment of the pleadings have made the issues raised in the three law actions identical with the issues raised in the equity cases based on the same bonds.'
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> • • • • • • • •
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> "The Master evidently so understood the issue. • • •
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> "The District Court so understood the issues. • • •
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> • • • • • • • •
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> "No issue is raised in the plaintiffs' brief except as to the validity of the bonds. *The obligation of the Surety Company based on the depositors of the Bank being injured by the giving of the bonds, and the receiver's claim against the Surety Company based on a trust relationship are not mentioned, and, we think, are not raised by the plaintiffs' counterclaim in the equity suits.*" (Italics supplied.)

The petitioners here seek to argue the question whether a receiver may not recover in the right of creditors. This question was not raised by the pleadings, and for that reason was not decided by the Circuit Court of Appeals.

> "As to whether the receiver by proper allegations of an injury to creditors, if based on facts, could have recovered in an action brought for the benefit of such creditor or creditors, is not raised by the pleadings" (R. 288).

The only ruling made by the Circuit Court of Appeals which touches the point argued by the petitioners was that the receiver could not rely upon a claim which he did not make in his pleadings. This ruling, even if it could be questioned on petition for certiorari, is not attacked, or even mentioned, either in the petition itself, or in the petitioners' brief.

The ruling is sound. It is unquestioned law. There is no conflict of opinion upon the principle.

> "The proofs must be according to the allegations of the parties; and if the proofs go to matters not within the allegations, the Court cannot judicially act upon them as a ground for its decision; * * *"
>
> Story, J., in *Harrison et al.* v. *Nixon,* 9 Pet. 483, 503.
>
> *Putnam* v. *Day,* 22 Wall. 60.
>
> *Pickard* v. *Clancy,* 275 Mass. 89.
>
> *Duane* v. *Merchants Legal Stamp Co.,* 227 Mass. 462, 468.

The ruling of the court below on this procedural point, not having been questioned in the petition for certiorari, would not be open to the petitioners on review.

> *Clark* v. *Willard et al.,* 294 U.S. 211.

II.

THE DECISION OF THE CIRCUIT COURT OF APPEALS RESTS UPON FIRMLY ESTABLISHED PRINCIPLES OF LAW ABOUT WHICH THERE IS NO CONFLICT IN THE FEDERAL COURTS.

The petitioners in their petition (pp. 4, 5), and in their brief (pp. 12 ff.), treat the decision of the Circuit Court of Appeals as though it were a broad declaration that in *no* case could a receiver of a national bank have rights which the bank did not have. No such broad ruling is involved in the decision of the court below. Its decision is based upon the case before it, as limited by the pleadings.

No one of the petitioners' specifications of error (Petitioners' brief, pp. 12, 13) sets forth an error warranting review by certiorari.

(1)

The Circuit Court of Appeals did *not* rule:

> "(1) That *all* defenses available against a national bank are available against its receiver after the bank has become insolvent, on the theory that such receiver stands no better than the bank itself." (Italics supplied.) (Petitioners' brief, p. 12.)

The court below ruled:

> "It is clear from the pleadings that the receiver seeks to recover on these bonds as assets of the Bank itself. In such an action he stands no better than the Bank itself" (R. 286).

(2)

The court below *did* rule, and properly (R. 286-288), substantially in accordance with specification numbered (2) (Petitioners' brief, p. 12):

"(2) That since Ragan (the Bank's president) knew that Cliff (the Surety Company's agent) was acting in fraud of his principal and violating the latter's instructions in executing the bonds, such knowledge on Ragan's part is to be imputed to the Bank with the result that the Receiver cannot recover on the bonds."

The principles involved are simply these:

A. Where the president of a bank receives an obligation for the bank with knowledge of its illegality, his knowledge is notice to the bank, which cannot enforce the obligation received through him and repudiate his knowledge.

B. Under such circumstances the receiver, seeking to recover on the obligation to the bank, stands in the shoes of the bank and cannot enforce the obligation on its behalf.

A. That Ragan's knowledge is imputed to the Bank, and prevents recovery by the Bank, seems clear. The Bank cannot take the bonds without being bound by the knowledge of its president, through whom it obtained them, that Cliff had no authority to issue them.

Curtis, Collins & Holbrook Co. v. *United States,* 262 U.S. 209, 222, 223.

Aldrich v. *Chemical Nat. Bank,* 176 U.S. 618, 627.

Bosworth v. *Maryland Cas. Co.,* 74 F. (2d) 519 (C.C.A. 7, 1935).

Porter v. *Beha,* 8 F. (2d) 65 (U.S. D.C. N.Y.).

Irving Trust Co. v. *State Bankers Financial Corp.,* 40 F. (2d) 90 (U.S. D.C. N.Y.).

Skud v. *Tillinghast,* 195 Fed. 1.

Tremont Trust Co. v. *Noyes,* 246 Mass. 197, 207.

Chapple v. *Merchants Nat. Bank,* 284 Mass. 122, 137.

Atlantic Mills v. *Indian Orchard Mills,* 147 Mass. 268, 275.
Loring v. *Brodie,* 134 Mass. 453, 457.
Skinner v. *Merchants Bank,* 4 Allen, 290.
Atlantic Bank v. *Merchants Bank,* 10 Gray, 532.
Metropolitan Trust Co. v. *Federal Trust Co.,* 232 Mass. 363, 367.

Since the Bank must trace its title through Ragan's act, it cannot recover on the bonds, because there is imputed to it (1) Ragan's knowledge that Cliff had no authority to write the bonds, and (2) the fraud upon the Surety Company, by which the bonds were obtained.

Porter v. *Beha,* 8 F. (2d) 65, *supra.*
Page v. *Trufant,* 2 Mass. 160, 162.
Hazard v. *Irwin,* 18 Pick. 95.

B. As it appears from the pleadings that the receiver seeks to recover on these bonds as assets of the Bank, he stands in no better position than the Bank itself. The law on this point in the federal courts is clear. It is cited in the *Opinion of the Circuit Court of Appeals* (R. 287), as follows:

> "* * * All defenses open against the Bank in such a case are open against the receiver, and he is chargeable with knowledge of all facts known to the Bank affecting the character of the claim. While there are decisions by state courts to the contrary, the federal decisions support this position. *Scott* v. *Armstrong,* 146 U.S. 499, 507; *Cutler* v. *Fry,* 240 Fed. 238; *Yates Center National Bank* v. *Schaede,* 240 Fed. 240; *Yates Center National Bank* v. *Lauber,* 240 Fed. 237; *Fourth Street Bank* v. *Yardley,* 165 U.S. 634, 653; *Skud* v. *Tillinghast,* 195 Fed. 1, 5; *Peterson* v. *Tillinghast,* 192

Fed. 287, 289; *Keyes* v. *First National Bank,* 20 Fed. (2d) 678, 686; *Burrowes* v. *Nimocks,* 35 Fed. (2d) 152, 159; *Schumacher* v. *Eastern Bank & Trust Company,* 52 Fed. 925, 928-9; *Rankin, Receiver* v. *City National Bank,* 208 U.S. 541, in which case it was held that where the president of the insolvent bank had manipulated the accounts of the bank by giving a note for which no consideration passed, the only purpose of the transaction 'in fact and contemplation was a swindle upon the bank examiner.' The court said that 'The whole business, from beginning to end, was and was intended to be a mere juggle with books and paper to deceive the bank examiner', and that if the insolvent bank 'had sued while it was a going concern it could not have recovered and the receiver stands no better than the bank.' The facts of this case are more fully stated in *Cherry* v. *City National Bank,* 144 Fed. 587, 591."

(3)

The court below did *not* rule according to specification numbered (3) (Petitioners' brief, pp. 12, 13):

"That no estoppel arises in favor of the receiver, even though (a) Cliff's written and publicly disclosed power of attorney included authority to write bonds of this type; (b) he gave said bonds with the intent that they should appear to be valid and enforceable obligations of the Surety Company in favor of the Bank; (c) he intended that the bonds should be shown to the bank examiners, [bank directors and other interested persons, and relied upon by them as valid obligations of his principal;] (d) the duplicate originals of Cliff's power of attorney were furnished to him by the Surety Company for the purpose of having them shown

or delivered to third parties dealing with Cliff as proof of his unlimited authority; [(e) the bank examiners saw and relied upon the bonds and the power of attorney; (f) the bank examiners failed to seasonably discover the unsound and eventually insolvent condition of the Bank because of such reliance; and (g) the Bank's depositors and other creditors suffered loss because of such reliance.]'' (Brackets supplied.)

The Circuit Court of Appeals made no ruling in regard to any estoppel of the Surety Company beyond ruling that the matters included in the brackets above were not alleged in the pleadings.

The matters not included in the brackets leave the case squarely within the decision of this honorable Court in the case of *Rankin, Receiver,* v. *City National Bank,* 208 U.S. 541, *supra.* The matters bracketed were not alleged in the suits at bar, and are not available to the receiver by way of estoppel.

The Philadelphia, Wilmington & Baltimore R.R. Co. v. *Howard,* 13 How. 307, 335.
Gilson v. *Nesson,* 208 Mass. 368, 370, 371.
Guild v. *Richardson,* 6 Pick. 364, 369.

As the action of the court below did not deal with the principle upon which the petition is based, no writ ought to be granted.

United States v. *Rimer,* 220 U.S. 547; 55 L. Ed. 578.

III.

EVEN IF THE PETITIONERS WERE NOT LIMITED TO THEIR PLEADINGS, THERE IS NO SUCH CONFLICT IN THE DECISIONS OF THE FEDERAL COURTS AS TO WARRANT REVIEW BY CERTIORARI.

The question, being one of general law, the federal courts apply the rule laid down in the federal decisions.

Salem Trust Co. v. *Manufacturers' Finance Co. et al.*, 264 U.S. 182, 191, and cases cited.
See also 12 U.S.C.A. § 24, note 12, and cases cited.

The cases cited by the petitioners in their brief (pp. 22, 23), as federal court decisions sustaining their contention that there is such a present conflict of authority as to warrant review by certiorari, do not support their contention.

There can be no conflict in the decisions of the several Circuit Court of Appeals on the case stated in the pleadings, because the case of *Rankin, Receiver,* v. *City National Bank,* 208 U.S. 541, *supra,* settles the law that where an apparent obligation is given to a national bank for the purpose of deceiving the bank examiner, and the bank as a party to the fraud could not recover, the receiver stands in the shoes of the bank and cannot enforce the obligation. It appears from the facts in that case, as stated in the report of the case in the lower court, *Cherry* v. *City National Bank,* 144 Fed. 587, that the City National Bank had full knowledge of the intended deception. To that extent the case at bar is a stronger case for the Surety Company, which had no such knowledge.

The petitioners claim a distinction here based on actual deception of the examiner, and consequent deception of and injury to creditors and depositors; and say now that such additional facts would enable the receiver to recover, though the Bank could not, as "representative of the creditors."

They did not plead such facts or such claim, however, and the Circuit Court of Appeals has ruled that they are bound by their pleadings, and that the receiver cannot recover on grounds upon which his actions were not based. The findings of the master and auditor upon these points, therefore, were of facts not in issue (R. 288), which have not been tried, and are as if never made.

But even if they had pleaded properly, and had proved, such deception and injury, the federal cases cited in their brief (pp. 22, 23) do not support the contention of the petitioners that there is such a present conflict of authority as to warrant review by certiorari.

Pauly v. *O'Brien*, 69 Fed. 460 (C.C. S.D. Col. 1895), decided thirteen years before the case of *Rankin, Receiver*, v. *City National Bank*, 208 U.S. 541, *supra*, was a case in which it appeared that the defendant had given his note for the purpose of having it take the place of a note of no value, as an asset of the bank. The court said that if this was not so, and the note was given for a fraudulent purpose, the defendant would still be bound. The defendant was a party to the transaction, whatever it was. The court makes no distinction between the bank and its receiver; and does not base its decision on actual deception of and injury to creditors and depositors.

Federal Reserve Bank of Richmond v. *Crothers*, 289 Fed. 777 (C.C.A. 4, 1923) involved a note given by the defendant, at the request of the president of the bank, to take the place of an equivalent amount of bonds, the note to be returned on sale of the bonds. The court held that there was no intention to deceive the bank examiner, but that the defendant intended the note to be used as a real asset of the bank. The *Rankin* case was distinguished, the court saying (p. 780):

> "Again, there the court held that the Guthrie Bank itself was a party to the fraud perpetrated for its own benefit, and therefore could not recover a fictitious credit entered in its favor by the City National Bank."

No question was raised as to any distinction between the rights of the bank and its receiver, nor was there any question of deception of or injury to creditors of the bank.

In *Hohning* v. *Caldwell,* 10 F. (2d) 298 (C.C.A. 5, 1925) five directors and stockholders gave a note to remove an impairment of assets of the bank. The note was discounted elsewhere and the proceeds were used to increase the bank's assets. The court held that there was consideration for the note. The court distinguishes the case of *Peterson* v. *Tillinghast,* 192 Fed. 287, on the ground that there (as here) the maker was a disinterested third person. No distinction was made between bank and receiver, nor was there any question of deception of and injury to creditors and depositors.

In the District Court case of *Utley* v. *Clarke,* 16 F. Supp. 435 (D.C. N.D. N.Y. 1936), the plaintiff, a stockholder and director, sought to recover back from the receiver securities which he had lent to the president of the bank to be used to remove an impairment of the bank's capital, knowing that the bank's records would show no obligation to him. There was no fraud on him. It was held that he could not recover back the securities as against depositors and creditors on the ground of want of consideration. The case does not seem to have reached the Circuit Court of Appeals.

None of these cases is at variance with this Court's decision in the *Rankin* case. None is at variance with the decision of the Circuit Court of Appeals in the case at bar.

So far as we can learn, in not one of the cases cited by the petitioners or found by counsel for the respondent has any

court, state or federal, denied his defenses to a defendant who was, like the Surety Company in this case, not only ignorant of the transaction but a victim of the fraud, and who sought no benefit from it.

Respectfully submitted.

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